Supreme Court, U. S.
F I L E D
OCT 28 1916
JAMES D. MAHER,
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BRIEF FOR RESPONDENT.

Supreme Court of the United States.

OCTOBER TERM, 1916.

No. 2.

JAMES SIM,

Petitioner,

against

WILLIAM EDENBORN,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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Supreme Court of the United States,

OCTOBER TERM, 1916.

No. 8.

JAMES SIM,

Petitioner,

against

WILLIAM EDENBORN,

Respondent.

Statement of the Case.

This case comes here on a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit (Trans. p. 865) to review the judgment of the Circuit Court of Appeals entered on July 7, 1913 (Tr. p. 863), reversing the judgment of the United States District Court for the Eastern District of New York in favor of petitioner for the sum of $94,962.90 entered upon the report of a referee appointed under a stipulation waiving a trial by jury (Tr., fols. 338-342).

The action is at law to recover certain sums of money claimed to have been obtained from petitioner and his assignors by respondent's fraud in procuring their signatures to a syndicate agreement. It was commenced in the Supreme

Court of Kings County, State of New York, and afterwards removed to the United States Circuit Court for the Eastern District of New York on the ground of diverse citizenship.

The complaint alleges that from the 15th day of April, 1902, until the 1st day of January, 1903, defendant (respondent) was engaged in promoting, forming and carrying out a syndicate agreement to purchase, develop and dispose of certain lands and properties and for the purchase of the United States Iron Company of New Jersey, capitalized at $1,000,000, and its properties, and for this purpose prepared a syndicate agreement, appointing defendant and J. C. Walker and August Mann syndicate managers; (this agreement appears at folio 301 of the Transcript); that the defendant submitted same to the subscribers thereto and procured their subscriptions to the same; that under the syndicate agreement the defendant occupied a relation of trust and confidence to the subscribers and it was his duty to make to them a full disclosure of all the facts and circumstances within his knowledge necessary to enable the subscribers to form an independent judgment and to protect their interests; that plaintiff, one of the subscribers, had unlimited confidence in and relied on and trusted defendant to the fullest extent (fol. 14). It was further alleged in the complaint that, as an inducement to plaintiff to subscribe, defendant by the terms of the said syndicate agreement represented and stated to the subscribers that an opportunity was afforded to acquire for a cash consideration the ownership, control and possession of the United States Iron Company of New Jersey, capitalized at $1,000,000, and that at the time the defendant induced plaintiff to subscribe to said syndicate agreement defendant

owned 5365 out of a total of 9250 shares of the capital stock of said United States Iron Company then outstanding, and, intending to deceive and defraud plaintiff and other subscribers, concealed from them the fact that he owned a majority of the capital stock of the said company and controlled it (fols. 17-18); that the plaintiff paid to the syndicate managers the amount due on his subscription in installments between July 20, 1902, and December 20, 1902, and received certificates of stock of the par value of $100 each in the Sheffield Coal & Iron Company (fols. 22-23). It is further alleged in the complaint that after procuring the execution of the syndicate agreement by the subscribers, defendant caused the name of the United States Iron Company to be changed to that of the Sheffield Coal & Iron Company and the stock to be increased, and called upon the plaintiff for the payment of his subscription which plaintiff paid as aforesaid, and on or about January 1st, 1903, defendant delivered to plaintiff said certificates of stock in the Sheffield Coal & Iron Company (fols. 26-27); that the plaintiff, after the discovery of the fraud, deceit and fraudulent concealment practiced on him by defendant, notified the syndicate managers, including the defendant, that he elected to rescind his subscription to said agreement and offered to return the said certificates of stock to the defendant and demanded of defendant payment of the money which had been paid to defendant on the subscription agreement, which demand was refused; that plaintiff was ready and willing to deliver said certificates and receive back the money paid the defendant (fols. 27-28).

The second and third causes of action set out in the complaint are based on allegations of sub-

stantially the same fraudulent acts on the part of the defendant in inducing the subscribers Cluff and Coles to sign the same syndicate agreement. The fourth cause of action is based on substantially the same claims of fraudulent representations and concealment practiced by defendant on Elmer E. Stone, which caused said Stone to authorize a subscription of $5,000 to the syndicate agreement (fol. 350).

A demurrer to the complaint (fol. 75) was sustained on the ground that the complaint constituted an equitable action involving the rescission of the agreement with the other subscribers to the syndicate while apparently setting forth a demand for a tort, and on the further ground that the complaint did not state facts sufficient to constitute a cause of action and that there was a defect of parties because the other syndicate managers and the Sheffield Coal & Iron Company were not made parties (fol. 94). Thereupon plaintiff amended his complaint, but the only substantial change made is the addition of a paragraph stating that the stock of the Sheffield Coal & Iron Company was worthless (fol. 162) and an allegation that the sums paid in by plaintiff on the syndicate agreement were paid to *defendant* (fols. 113, 114). The defendant demurred to the amended complaint and the same Judge who passed on the first demurrer held that the complaint stated a cause of action at law based on a rescission of the contract and overruled the demurrer. A decision was entered which recited: (1) that the complaint stated facts sufficient to constitute a cause of action; (2) that there was no defect of parties defendant and (3) that the complaint stated a cause of action at common law, based on a rescission of a contract alleged to have been procured by fraud

(fol. 177). Interlocutory judgment was entered overruling the demurrer (fol. 69).

The defendant in his answer (fol. 85) denied the material allegations of the complaint, except that he admitted the execution of the syndicate agreement which was annexed to the answer as an exhibit (fol. 301).

The parties by stipulation referred the issues of law and of fact to Edward W. Hatch, referee, to hear and determine, and an order was accordingly entered (fols. 338-342). After a trial the referee made a report finding that defendant solicited plaintiff and his assignors to become subscribers to the syndicate agreement which authorized and contemplated the purchase of the stock of the United States Iron Company and other properties by the managers of the syndicate (fol. 347); that defendant did not disclose to them at or prior to the signing of said syndicate agreement his ownership of shares of stock in the United States Iron Company (fols. 348-349); that they signed the agreement in ignorance of defendant's interest in said corporation (fol. 350); that it was defendant's duty to make a full and complete disclosure of his interest in the United States Iron Company (fol. 351); that upon the discovery of his interest in said corporation the plaintiff and his assignors elected to rescind their subscriptions, and gave notice of such fact to the syndicate managers, and offered to return and restore the stock which each had received, and demanded the return of the money paid therefor (fol. 352); that defendant and the syndicate managers refused to accept the stock and return the money (fol. 353). The referee also found that at the time of the formation of the syndicate, the United States Iron Company was the owner of valuable iron properties in and about Sheffield, Alabama (fol. 2153); that defend-

ant made no statements to the plaintiff and his assignors with intent to deceive, defraud or mislead (fol. 2158); that defendant had not intentionally concealed his interest in the United States Iron Company or his ownership of stock from plaintiff and his assignors (fols. 2163, 2164, 2172, 2179, 2184, 2188, 2193); that no statement or action of the defendant was made for the purpose of leading the plaintiff or his assignors to believe that the defendant was not interested in said property or stock (fol. 2163). He further found that the plaintiff herein and each of his assignors knew that the defendant was largely interested in the formation of the syndicate and in the carrying out of its objects and purposes and was devoting considerable time thereto (fol. 2164). He further found that at a meeting of the stockholders of the Sheffield Coal & Iron Company held on June 9, 1903, the minutes of the annual meeting of the stockholders of the United States Iron Company held on June 10, 1902, were read and approved and that at this last named meeting the plaintiff Sim and his assignor Cluff were present in person and his assignors Coles and Stone were represented by proxy (fol. 2167); he further found that the minutes of the meeting of the stockholders of the United States Iron Company held on June 10, 1902, which were read and approved at said meeting of the stockholders of the Sheffield Coal & Iron Company held on June 9, 1903 showed the defendant's ownership of the stock of the United States Iron Company and the extent thereof (fol. 2169); he further found that at the time of the formation of said syndicate, the United States Iron Company was the owner of valuable iron ore property in and about Sheffield, Alabama (fol. 2153) and that the defendant believed that the operations of the

company which was to succeed the syndicate would be very profitable (fol. 2154); that at the time of the formation of the syndicate the defendant's interest in the United States Iron Company was known to a number of persons interested in the iron and steel industry and that the same had been the subject of publication on September 18, 1902 in the "Iron Age", the standard iron and steel trade paper (fol. 2162); that the plaintiff Sim had heard of the defendant's ore properties prior to the time of subscribing to the syndicate agreement (fol. 2175) and that he had heard of the proposed syndicate from Mr. Cluff before he had any conversation with defendant concerning it (fol. 2177) and that the defendant mentioned to the plaintiff Sim the name of the company the stock of which was to be acquired and where its properties were located (fol. 2177); that the defendant told plaintiff's assignor Mr. Cluff, in 1901, that he had bought out Mr. Gates' interest in the United States Iron Company (fol. 2191); that sometime in the year 1902 Mr. Coles learned that defendant had purchased Mr. Gates' interest in the property of the United States Iron Company (fol. 2196); the referee also found that the Sheffield Coal & Iron Company had become insolvent and that its stock had become practically worthless (fols. 2271-2272) notwithstanding that he found that it owned valuable ore properties in and around Sheffield, Alabama (fol. 2153).

The referee, following the opinion of the Court of Appeals in the case of Hecksher *v.* Edenborn (203 N. Y. 210), held that defendant's failure to disclose his interest in the United States Iron Company operated in law as a fraud on plaintiff and his assignors (fol. 355) and directed judgment in favor of plaintiff for the amount sued for with interest (fol. 358). Judgment was

entered denying defendant's motion for a new trial and in plaintiff's favor for the sum of $94,962.90 (fols. 400-402).

It is clear from an examination of the findings of fact and from the opinion of the referee that he did not believe and did not find that the defendant was guilty of any actual fraud, but based his conclusion that plaintiff was entitled to recover solely on constructive fraud on defendant's part in failing to disclose his interest in the United States Iron Company at the time the subscription agreement was signed. (See opinion of the referee Trans. fols. 374-376, 380, 381, 387).

On writ of error the Circuit Court of Appeals held that the facts found by the referee did not support the judgment entered (Trans., page 862); that defendant performed his duties as manager for and on behalf of the whole syndicate and not for and on behalf of any one subscriber; that he received the subscription of each subscriber on behalf of all and made the contemplated purchase and outlays on behalf of all, and that when the defendant sold his stock in the United States Iron Company to the reorganized Sheffield Coal & Iron Company, he sold it to that company as successor to the rights of all the subscribers to the syndicate; that if there was constructive fraud on Edenborn's part in not informing his subscribers of his personal interest in the stock of the United States Iron Company, the fraud was on the whole syndicate when the purchase was proposed and on the reorganized Sheffield Coal & Iron Company when the purchase was made; and that plaintiff could not restore the defendant to his original position by tendering him the stock plaintiff had received in the reorganized company, which stock represented a proportionate interest in other properties

greatly exceeding in value the amount of the defendant's interest in the original capital of the United States Iron Company (Transcript page 862); that if the syndicate subscribers had any right of rescission that right must be worked out through the purchasing company; that because of the peculiar situation of this case, no right of rescission existed in favor of the plaintiff (fol. 863). The plaintiff thereupon applied to this court for a writ of certiorari, which was granted.

We shall discuss the following questions involved on this certiorari:

(1) No principle of law was violated by respondent in procuring the execution of the syndicate agreement.

(2) No cause of action exists in petitioner's favor for money had and received, because the syndicate and not respondent received petitioner's money.

(3) The only agreement that can be rescinded is the agreement between the syndicate managers and Edenborn.

(4) Petitioner has not offered to place respondent *in statu quo* without which there can be no rescission. The findings of fact set out the syndicate agreement in full and show that it was carried out, but do not show that respondent can be placed *in statu quo*. In fact the findings show that respondent cannot be placed *in statu quo* and for this reason there is error of law in the judgment entered upon the facts found by the referee.

(5) The complaint is demurrable in that it fails to set out the syndicate agreement and fails to show that the circumstances were such that a rescission could be had and fails to show that respondent was placed *in statu quo*, or that petition-

er offered to place him *in statu quo,* and that he could be placed *in statu quo.* The complaint was demurrable because there was a defect of parties in that Walker and Mann, the other syndicate managers, were not made parties and in that the Sheffield Coal & Iron Company, which succeeded to the rights of the syndicate managers, was not made a party.

The suing out of the writ of error and assigning error on the action of the court in overruling respondent's demurrer to the complaint bring up for review the sufficiency of the complaint. In addition to this, the question as to whether the complaint states a cause of action is a question of law arising upon the face of the record and is one that is open for the consideration of this court without an exception and without an assignment of error.

The question as to whether or not the findings of fact made by the referee support the judgment entered is a question of law that arises on the f of the record and if the findings of fact do not support the judgment, this is an error of such controlling character that this court will notice it even without an assignment of error.

Chicago, Rock Island and Pacific R. R. Co. *v.* Barrett, 190 Fed. Rep. 118;
Seeberger *v.* Schlesinger, 152 U. S. 581;
Guaranty Trust Co. *v.* Koehler, 195 Fed. Rep. 669;
Paine *v.* Central Vermont R. R., 118 U. S. 152;
Roberts *v.* Benjamin, 124 U. S. 64;
Lupton *v.* Auto Club, 225 U. S. 489, 495;
Chicago, Milwaukee & St. Paul R. R. *v.* Clark, 178 U. S. 353.

BRIEF OF ARGUMENT.

POINT I.

No principle of law was violated by respondent in procuring the execution of the syndicate agreement by petitioner and his assignors.

The referee has found the execution of the syndicate agreement (fol. 347); that at the time of the execution of the agreement by plaintiff and his assignors they had no knowledge of defendant's ownership of shares of stock in the United States Iron Company (fol. 350); that it was defendant's duty at and prior to the signing of said agreement by the subscribers to make a full and complete disclosure of his interest in the United States Iron Company (fols. 350-351). This finding of fact is also stated as a conclusion of law (fol. 354). This is the only finding in this case on the subject of fraud. There is no finding that defendant knew that the plaintiff and his assignors were ignorant of defendant's ownership of the shares of stock in the United States Iron Company; on the contrary, the referee found that defendant's interest in the United States Iron Company at the time of the formation of the syndicate agreement was known to a number of persons interested in the iron and steel industry and had been the subject of publication on September 18th, 1902, in the "Iron Age," the standard iron and steel paper (fol. 2162). This publication appeared before plaintiff and his assignors had paid the whole amount of their subscriptions under the syndicate agreement (fol. 356). The referee found that the minutes of the meeting of the stockholders of the

United States Iron Company held on June 10th, 1902 (which was before any money was paid by plaintiff and his assignors on said subscription) showed defendant's ownership of stock of the United States Iron Company (fols. 2168-69). These minutes were read at the meeting of the stockholders of the Sheffield Coal & Iron Company held on June 9, 1903, and were approved at said meeting. At this meeting the plaintiff Sim and his assignor Cluff were present in person, and the assignors Coles and Stone were present by proxy (fol. 2168). The referee also found that plaintiff Sim had heard of defendant's ore properties prior to and at the time of his subscription to the syndicate agreement (fol. 2175); that the defendant told plaintiff's assignor Cluff in 1901 that defendant had bought out Gates' interest in the United States Iron Company (fol. 2191); that some time in the year 1902 plaintiff's assignor Cole learned that defendant had purchased Mr. Gates' interest in the property of the United States Iron Company (fol. 2197).

Defendant excepted to the 6th finding of fact to the effect that it was defendant's duty to make a complete disclosure to the syndicate subscribers prior to procuring their signatures to the agreement (fol. 2312), and excepted to the first conclusion of law which was to the same effect (fol. 2313); also excepted to the 1st, 2nd, 3rd and 4th conclusions of law (fol. 2313).

Defendant assigned as error the action of the referee in making said sixth finding of fact (fols. 2478-79) and also assigned as error the first conclusion of law made by the referee (fol 2483); the defendant also excepted to the third conclusion of law to the effect that plaintiff was entitled to recover moneys paid by plaintiff and his assignors

to the syndicate managers on said subscription agreement (fol. 2314), and assigned error thereon (fol. 2485); also assigned error to the action of the referee in directing judgment for plaintiff (fols. 2364-2365).

In the case of Hecksher *v.* Edenborn, 203 N. Y. 210, 219, Judge Hiscock, speaking for the Court of Appeals of the State of New York, in discussing the same agreement as involved in this action, said: "There is nothing to indicate that defendant acquired his stock in the United States Iron Company for any such purpose (that is, acquired it at a certain price for the purpose of sale to the corporation, and afterwards sold it to the corporation for a much higher price) or that the stock purchased by him and his associate managers in that company was not fairly worth the price paid for it, which was $30 per share less than the price fixed in the syndicate agreement. But broadly speaking, the complainants must rest their claim to relief on the basic principle that defendant induced them ignorantly to execute an agreement which violated the rule that an agent to buy may not purchase of himself."

At page 220, he said: "It (an action to recover based on a rescission) must stand as one directed against the syndicate agreement itself. If that was valid, plaintiff cannot succeed because under it and subsequently defendant did some illegal act in violation of it."

In the same case when before the Appellate Division, Second Judicial Department of the State of New York (131 A. D. 253), Justice Miller in discussing the same syndicate agreement said: "It may be conceded that the defendant was guilty of constructive fraud in purchasing for the syndicate the stock of the United States Iron Com-

pany, but the defendant's principal was the syndicate which was succeeded by the corporation, and the right of the syndicate or its successor, the corporation, to rescind the purchase of said stock does not give the syndicate subscribers the right to rescind their subscription contract. The contract of purchase of said stock, not the subscription contract, was rendered voidable by the defendant's constructive fraud."

At page 267, he said: "Here we have a case in which no fraud inducing the subscriptions is shown; but only a constructive fraud subsequent to the syndicate agreement upon the syndicate members generally to whose rights a corporation has succeeded. Obviously, in such a case the stockholders cannot in an action at law for damages compel the defendant to purchase their stock. Their action, if they have one, is a representative action."

The Circuit Court of Appeals concurred with the views expressed by Mr. Justice Miller (Transcript page 863).

We cannot persuade ourselves to the conclusion arrived at by the referee in this case based on the opinion of the Court of Appeals in the Hecksher case. We think the opinion expressed by Mr. Justice Miller in the Hecksher case and concurred in by the Circuit Court of Appeals in this case, expresses the correct view of the law applicable to the facts presented here.

It is well established that the rule of law announced in the Hecksher case is not binding on this court because a question of general jurisprudence is involved in which this court will exercise its own independent judgment (City of Chicago *v.* Robbins, 2 Black, 418; Burgess *v.* Seligman, 107 U. S. 20; Gardner *v.* Michigan Central R. R. Co., 150 U. S. 349, 358).

If A appoints B as A's agent to purchase ten shares of stock of the United States Steel Corporation, 10 shares of stock of the New York Central Railroad Company and 10 shares of stock of the Western Union Telegraph Company, the mere fact that B at the time the contract was made is the owner of ten shares of stock of the United States Steel Corporation does not make the contract by which B was appointed agent either void or voidable. The law was not violated until the stock owned by B was purchased by him as agent for A. Upon subsequently learning the fact, A could perhaps keep the stock and sue for damages, or even if he had suffered no damage might rescind the transaction, return the stock and recover the amount paid. The transaction upon which the law frowns is the sale by the agent to buy, of his own property, to his principal. So here the syndicate was formed to purchase the stock of the United States Iron Company in which (Edenborn owned an interest, and also *valuable coal and other properties* in which Edenborn had no interest (fol. 302). The syndicate agreement further provided that, "the parties hereto hereby form a syndicate to purchase, acquire, use, develop and dispose of the lands and properties above mentioned or *so much* or *such part* thereof as in the *judgment* and *opinion* of the *syndicate managers* is deemed advisable and proper" (fol. 306); it further provided, "should the syndicate managers in the exercise of their absolute power and discretion hereunder, sell, convey, or transfer any of the money or property acquired by the syndicate, for either cash, bonds, stock or securities, each of the subscribers hereto shall be entitled to receive on the termination of this agreement and the dissolution of this syndicate his *pro rata* share thereof." It further pro-

vided, "each and all the rights, liabilities, acts, undertakings, powers and authorities of the syndicate managers under this agreement and in pursuance thereof shall control and become operative and in force by the act of assent of any two thereof and each and all matters and things to be done or performed in and under this agreement, and in and by said syndicate, and in and by all depositaries, agents, trustees and all other persons, firms and corporations connected therewith, shall be done and performed and carried out on the request, judgment and direction of the said syndicate managers when done by the act or assent of any *two* thereof" (fol. 320).

When all subscriptions to the syndicate agreement had been procured, that contract became operative and the subscribers became bound each to the other for the amount of their respective subscriptions. If one of the syndicate managers was subsequently guilty of fraud in purchasing for the syndicate property in which he had an interest, that might, under certain circumstances, entitle the syndicate to rescind the purchase, but would not entitle any syndicate subscriber to rescind the syndicate agreement which had previously been made and had become binding upon him. The syndicate agreement could not be rescinded. Edenborn was not the agent of Sim and his assignors at the time they signed the syndicate agreement and became bound by its provisions. The agreement stated its purposes in language clear and explicit and the subscribers thereto were left free to determine whether or not they would execute it. When a subscriber signed the agreement he assumed certain contract obligations not only to the syndicate managers but to the other subscribers. His signature might influence others to subscribe. The subscriber, at the

time he subscribed, was representing himself on one hand and dealing with the syndicate managers on the other. The subscribers could have readily obtained all the information they desired about the ownership of the property if they only asked for it. It was just as much their duty to inquire as it was the duty of Edenborn to disclose without being asked. On the other hand, a fair inference from the findings heretofore set out is that Edenborn believed that the plaintiff and his assignors knew that he was interested in the stock of the United States Iron Company, and it is clear that this is the reason he did not speak affirmatively on this subject.

It appears from the syndicate agreement itself that it was discretionary with the syndicate managers whether they would buy Edenborn's interests in the United States Iron Company. The agreement provided that the syndicate managers should purchase the properties therein described or *so much* or *such part* thereof as in the judgment and opinion of said syndicate managers was deemed advisable and proper (fol. 306).

The Court of Appeals holds in the Hecksher case that the validity of the syndicate agreement must be determined as of the date of its execution, and that it cannot be declared invalid because after its execution the defendant did some illegal act in violation of the agreement. We contend that the Court of Appeals erred in holding that the syndicate agreement was fraudulent in its inception. Suppose the syndicate managers had not purchased the stock of the United States Iron Company, but had purchased stock or property in which Edenborn had no interest as they were authorized to do by the terms of the agreement, and that this purchase of such other property was afterwards fully carried out, could the plaintiff have

rescinded the syndicate agreement after such purchase simply because the syndicate managers had been empowered by the agreement to purchase Edenborn's property? Suppose Edenborn had in good faith after the execution of the syndicate agreement sold his stock in the United States Iron Company to a third party, and that Edenborn had thereafter become disabled to act as one of the syndicate managers and the other two managers had thereafter filled the vacancy caused by his disability, as was authorized by the syndicate agreement, and that such syndicate managers had subsequently purchased the shares of stock Edenborn had owned in the United States Iron Company from the person to whom Edenborn had sold it, could the plaintiff have thereafter rescinded the syndicate agreement because Edenborn had failed to disclose his interest in the United States Iron Company at the time he procured plaintiff's consent to that agreement? Suppose that after plaintiff had signed the syndicate agreement Edenborn had died and the two remaining members of the syndicate had selected another person as a syndicate manager to take the place of Edenborn, and that the syndicate had purchased the Edenborn stock from the executor or administrator of his estate, could plaintiff have rescinded the syndicate agreement because of Edenborn's failure to disclose his interest in the United States Iron Company at the time plaintiff signed the agreement? Suppose that *Mr. Walker,* one of the syndicate managers, had solicited plaintiff to subscribe to the syndicate agreement just as was done by Mr. Edenborn, then suppose the syndicate managers had in the exercise of their discretion under their agreement decided not to purchase Mr. Edenborn's stock in the United States Iron Company but had purchased other property not owned by

Edenborn, could the plaintiff rescind his subscription to the syndicate agreement simply because the agreement conferred on the syndicate managers power to purchase Edenborn's stock, and because Mr. Walker had not informed plaintiff of Edenborn's ownership of the stock of the United States Iron Company at the time plaintiff signed the syndicate agreement?

The fact that Edenborn was a member of a syndicate composed of three members, the other two not being controlled by Edenborn, and that the decision of any two of such members controlled with respect to the subject matter of the syndicate agreement, coupled with the fact that the syndicate agreement authorized the syndicate managers in their discretion to purchase certain property —a part of which was owned by Edenborn— from one of such syndicate managers, is not alone sufficient to justify the setting aside of the syndicate agreement on the ground of constructive fraud based on the fact that the syndicate manager who owned such property failed to disclose his ownership therein at the time one of the syndicate managers procured plaintiff to sign the syndicate agreement.

We think that there is no constructive fraud in the procuring of the execution of this syndicate agreement for the reason that it could be carried out without purchasing Edenborn's property. It could be executed without operating as a fraud on the subscribers. The presumption must be indulged that at the time of the execution of this agreement the syndicate managers intended to discharge their duties to the subscribers and intended to do everything required of them by law in carrying out the terms of said agreement. It cannot be assumed that at the time of the procuring of

the execution of the syndicate agreement the syndicate managers intended to commit a breach of trust. It must be assumed that they did not intend as syndicate managers to exercise their discretionary power to purchase Edenborn's property without informing the subscribers of such intention and having them sanction such purchase, if the law required such sanction.

Suppose the syndicate managers under this agreement which authorized them in their discretion to purchase Edenborn's property, had decided to purchase said property and had prior to said purchase referred their proposed action to the subscribers for approval, and that plaintiff then for the first time learned that Edenborn owned an interest in such property; suppose the subscribers had refused to sanction such purchase and the syndicate managers thereafter purchased other property in which Edenborn had no interest, could the plaintiff thereafter rescind his subscription to the syndicate agreement because of the failure of a syndicate manager to disclose Edenborn's ownership of the stock of the United States Iron Company.

Suppose the syndicate agreement had not conferred on the syndicate managers the discretionary power to purchase property, a part of which it afterwards develops was owned by Edenborn, but that the agreement had conferred general power upon the syndicate managers to purchase whatsoever property they desired for blast furnace purposes; suppose after an investigation by the snydicate managers they had come to the conclusion that the most desirable property for this purpose was owned by Edenborn, and suppose this conclusion had been arrived at independently of any act or influence of Edenborn; suppose the other two syndicate managers had in

good faith purchased from Edenborn said property at its reasonable market value, and suppose that in this sale to the other two syndicate managers Edenborn had acted for himself and not for the syndicate members, could plaintiff have rescinded the syndicate agreement because two of the syndicate managers had purchased Edenborn's property in the absence of proof of actual fraud, or unfair dealing, or undue advantage, on the part of Edenborn?

We think the law is well settled that "contracts and transactions between individuals and corporations of which they are directors or officers, which are fair, which are made in good faith, which do not secure to individuals any undue or unjust benefit or advantage, and in which the interest of the individuals and the duty of the officers work in unison for the welfare of the corporation, are valid and enforcible both at law and in equity". (Wyman *vs.* Bowman, 127 Fed. Rep. 257, 273).

Twin Lick Oil Co. *vs.* Marbury, 91 U. S. 587;
Hotel Co. *vs.* Wade, 97 U. S. 13;
Continental Insurance Co. *vs.* N. Y. & Harlem R. R. Co., 187 N. Y., 225, 238;
Burden *vs.* Burden, 159 N. Y., 287, 307, 308.

In purchasing the property of Edenborn under the terms of the general syndicate agreement above described which does not specifically authorize the purchase of Edenborn's property, such purchase, when made in good faith and for a fair consideration, if it can be set aside at all, can be done only at the instance either of the syndicate managers, or of a majority of the members of the syndicate. As we understand the law an individual stockholder of a corporation cannot

enjoin the execution of a contract between the board of directors of a corporation and one of the members of the board unless fraud, undue advantage or unfairness is shown. (Cowell *vs.* McMillan, 177 Fed. Rep. 25.) If the contract is not unfair to the corporation and is made in good faith, and secures to the director no undue or unjust benefit or advantage, an individual stockholder cannot complain unless he can establish fraud.

Burden *vs.* Burden, *supra;*
Continental Insurance Co. *vs.* N. Y. & Harlem R. R. Co., *supra.*

If it would be lawful for the other two syndicate managers to purchase Edenborn's property under the terms of a similar agreement to that involved here, but which did not mention Edenborn's property, and if such purchase could not be set aside by a syndicate member, in the absence of fraud, unfair dealing, or undue advantage on the part of Edenborn in making the sale, then on what theory can the syndicate agreement in this case be rescinded by plaintiff merely because it authorized the syndicate managers to make a purchase from one of the syndicate members, a purchase which could be lawfully made under proper safeguards without special authority for that purpose in the syndicate agreement?

The decision of the Court of Appeals that the syndicate agreement can be rescinded under such circumstances involves the assumption that the syndicate managers in carrying out the terms of the syndicate agreement would violate their duty to the subscribers, when the law presumes the contrary if the contrary can be done under the terms of the agreement. The syndicate agreement can be carried out without violating the law, without

any breach of trust by the syndicate managers even in the purchase of Edenborn's property as hereinbefore set forth. Therefore, this syndicate agreement cannot be rescinded on the ground that Edenborn was guilty of constructive fraud in procuring its execution by plaintiff. It is only a breach of duty under an agreement that can be set aside, not the agreement itself; hence, the rule laid down by the Court of Appeals in Hecksher *vs.* Edenborn, is manifestly wrong. The effect of the opinion in that case is that the agreement can be rescinded, not because the law must inevitably be violated, but because it is possible that there may be a breach of duty by the syndicate managers.

The right or discretion of the syndicate managers to purchase Edenborn's property does not constitute a violation of the rule that an agent to buy cannot buy of himself. If the syndicate managers had purchased Edenborn's property, and if in making such purchase Edenborn had acted as one of the syndicate managers, then it is obvious that the syndicate subscribers could have rescinded the transaction, or the corporation subsequently formed could have rescinded it, and any subscriber after calling upon the syndicate manager or the corporation to bring an action, and their refusal so to do, could maintain a representative action for this purpose. If, however, the syndicate managers had purchased Edenborn's property, and if in making such purchase Edenborn had not acted with or as one of the syndicate managers, but had acted only for himself in making the sale, and if such sale was made in good faith, and no unfair advantage was taken of the syndicate managers, such sale could be rescinded, if at all, only by action of a majority of the subscribers.

POINT II.

The findings do not support the judgment because they show that the moneys were paid by the plaintiff and his assignors to and received by the syndicate managers as such and were not paid to and received by the defendant.

The original complaint alleges that the moneys sued for were paid to the syndicate managers (fols. 22, 23). The amended complaint alleges that the moneys sued for were paid to and were received by the defendant (fols. 114, 125, 137, 155). The referee found at the request of the defendant as follows: "That all of the managers of said syndicate acted in carrying out the syndicate agreement and that the subscriptions of the plaintiffs and his assignors were paid to, and received by all of said managers as such" (fols. 2166-2167, 352-353). This finding is in effect a finding that the terms and provisions of the syndicate agreement in respect to the receipt and disbursement of moneys were carried out (fols. 307, 311, 320). On this finding of fact the referee based the conclusion of law that plaintiff was entitled to recover of the *defendant* the sums of money paid by plaintiff and his assignors to the *syndicate managers*. The defendant excepted to this conclusion of law (fol. 2414, 2485) and assigned error thereon (fol. 2485).

We contend that plaintiff was not entitled to recover anything in this action because the finding of the referee shows that the sums of money paid by the plaintiff and his assignors under the terms of the syndicate agreement were paid to the syndicate managers as such, and not to the defendant.

The findings do not show that defendant received any of this money. This money evidently went into the possession of the Sheffield Coal & Iron Company either in the shape of money or property, and not into the possession of the defendant (fols. 359, 2166).

When a party has been induced by fraud to enter into a contract he has two actions at law, the one based on a rescission, and the other for damages, but he cannot resort to both, for they are inconsistent; or, he may sue in equity for a rescission, in which event an accounting takes the place of damages. This is an action at law against the defendant for money had and received by the defendant based on an attempted prior rescission of the syndicate agreement for fraud. The plaintiff below elected to stand on his cause of action based on a rescission (fol. 1530); that is, he claimed that he had rescinded the contract on account of fraud and offered to return to the defendant the stock of the Sheffield Coal & Iron Company, and demanded of the defendant the return of the money which he alleged he had paid to him, but which the referee finds was received by the syndicate managers as such. By this act, the person defrauded assumes in law the ownership of the consideration with which he parted as the result of the fraud, and the law implies a promise on the part of the person to whom such money was paid to return it, because such person holds it without having paid any consideration therefor. The complaining party may then in an action for money had and received, recover from the party guilty of the fraud whatever he may have paid him.

It is well settled that an action to recover moneys paid upon a contract rescinded by one of the parties on the ground of fraud is based on the

promise to pay implied by law and is therefore an action for money had and received.

Freer *v.* Denton, 61 N. Y. 492, 495.
Byxbie *v.* White, 24 N. Y. 607.
Hecksher *v.* Edenborn, 131 A. D. 253.
Gould *v.* Cayuga Bank, 86 N. Y. 75.
Lambert *v.* Elmendorf, 101 A. D. 758.
Wilson *v.* U. S. Cattle Ranch Co., 73 Fed. 994.
Bridge *v.* Penniman, 9 Jones & Spencer, 183.

In Limited Investment Association *v.* Glendale Association, 99 Wisc. 54, 58, Judge Bardeen, speaking for the Supreme Court of Wisconsin, said, in discussing an action for money had and received: "The rule is quite elementary that to enable a person to maintain an action for money had and received it is necessary for him to establish that the persons sought to be charged have received money belonging to him, or to which he is entitled; that is an elementary fact on which the right of action depends (*National Trust Co.* v. *Gleason*, 77 N. Y. 400). The purpose of such an action is not to recover damages but to make the party disgorge, and the recovery must necessarily be limited by the party's *enrichment* from the alleged transaction. The evidence of crooked dealings or fraudulent practice is only important in determining the party's right to secure the funds. While it may be admitted that all the defendants are joint tort feasors to the extent that they would be jointly liable for all *damages* the plaintiff sustained by reason of their fraud, yet when it is sought to render them liable on a *quasi* contract a different rule prevails. The basis of recovery in the latter case being a loss on the one side and consequent enrichment on

the other, liability can only exist in so far as these elements concur. There is no implied promise to pay damages. The promise that the law implies is that the guilty party will restore that which he has received and which the other has shown himself entitled to. To the extent, therefore, which it is shown that one party has suffered loss and the other gained profit, can the recovery in this form be sustained. The law does not imply a promise to pay for something a party has not received, while in the case of a tort it casts upon him an obligation to pay all the damage done, regardless of a promise."

See also:

National Trust Co. *v.* Gleason, 77 N. Y. 400.

N. Y. Guarantee & Indemnity Co. *v.* Gleason, 78 N. Y. 503.

Phoenix Bridge Co. *v.* N. J. Iron Co., 30 A. D. 614.

Cyc, Vol. 27, page 860.

Of course, if the syndicate managers had acted with Edenborn in fraudulently obtaining plaintiff's money so that they would be joint tort feasors, and if the evidence showed that each wrongdoer was the agent for the other the receipt of the plaintiff's money by the syndicate managers would be a receipt of same by Edenborn. But there are no such facts in this case. There is no finding that any fraud, actual or constructive, was committed by the other two members of the syndicate who had the power and authority to control in every respect the action of the syndicate, or that they knew of and participated in the alleged fraudulent acts of Edenborn.

The undisputed evidence and the findings show that this money went through the syndicate, of

which Edenborn was a member, to the Sheffield Coal & Iron Company, and that this company had the whole beneficial interest in this money and in the property acquired by the syndicate with the syndicate funds. The fact is that Edenborn did not receive this money personally and there is no finding that he did receive it personally. All the plaintiff's money went to pay for property in which Edenborn had no interest and which was transferred to the Sheffield Coal & Iron Company. None of plaintiff's money was used to acquire Edenborn's stockholdings in the United States Iron Company. For his interest in the stock of the United States Iron Company amounting to $536,500, par value, he received $375,550. of the stock of the Sheffield Coal & Iron Company.

Let us concede for the moment that plaintiff is entitled to rescind the syndicate agreement because of Edenborn's failure to disclose his ownership of the stock of the United States Iron Company. Even with this concession is plaintiff entitled under the findings in this case to recover from the *defendant* the moneys paid to the syndicate managers? Suppose that shortly after signing the syndicate agreement and the payment of the money on his subscription to the syndicate managers, the plaintiff had learned of Edenborn's interest in the stock of the United States Iron Company and plaintiff thereupon undertook to rescind the subscription agreement, and desired to take the proper legal steps to recover the moneys paid by plaintiff to the syndicate managers in an action for money had and received, how would he proceed? The money is no doubt in the bank to the credit of Edenborn, Walker and Mann as syndicate managers. This money is held by the syndicate managers in trust as part of the common fund of all the syndicate sub-

scribers, and is to be used for the common enterprise in which all the subscribers are interested, and is to be held and devoted by the syndicate managers, as the representatives of all the subscribers, in carrying out that enterprise, and the common fund in this case was actually devoted to that purpose. There was never any contract that Edenborn should receive a dollar of plaintiff's money, and there is no finding that he did receive any of said money. In order to recover, it would be necessary for plaintiff to sue the syndicate managers and all the syndicate subscribers. Whatever the form of action, whether at law based on a rescission, or in equity for a rescission, we think that the syndicate subscribers would be necessary parties, as each syndicate subscriber has an interest in the common fund. The syndicate agreement provides that "the subscribers severally agree with each other and with the syndicate managers, as follows" (fol. 305).

Being an action at law for money had and received it would doubtless be necessary for the court to appoint a receiver of the common fund in the hands of the syndicate managers and perhaps grant a temporary injunction restraining the syndicate managers from disposing of the funds pending the action. At the termination of the litigation, if plaintiff was successful, plaintiff would be paid from the common fund in the hands of the receiver. Plaintiff would thus obtain his money from the party who had actually received it, that is, from the syndicate managers. The syndicate subscribers would be concluded by this litigation because they were parties thereto, and possession of the common fund would confer jurisdiction of the persons of all the subscribers, even if personal service could not be made on all the syndicate sub-

scribers. It is obvious that if an action in equity were brought for a rescission, the syndicate managers and the syndicate subscribers would all have to be made parties in the same manner as in an action at law.

The referee in holding Edenborn liable in an action for money had and received seems to have confused Edenborn with the syndicate managers, and this in the face of the fact that the funds were received by the syndicate managers as such. The fact that Edenborn was guilty of a constructive fraud, which caused plaintiff to pay money to a third party, the syndicate managers, is not sufficient to make Edenborn liable to plaintiff for said money in an action against Edenborn for money had and received. Edenborn might be liable to the plaintiff in an action for damages sustained by plaintiff as the result of defendant's alleged fraud, but not in an action for money had and received. The important fact in an action of this character is the receipt of the money by Edenborn.

If the judgment in this case would stand against Edenborn for money had and received it would also stand if it had been obtained by plaintiff against August Mann, who was also one of the syndicate managers, for the reason that Mann personally received this money just as much as Edenborn did. Suppose plaintiff had sued Mann instead of Edenborn and had alleged that plaintiff's signature to the syndicate agreement was procured by the fraud of Edenborn, just as is alleged here, and that as the result of said fraud plaintiff had paid over the amount due under his subscription agreement to the defendant Mann; and suppose the proof had disclosed, just as here, that the money was paid to the syndicate managers, would plaintiff be entitled to a judgment against Mann

for money had and received to plaintiff's use? Certainly not, because this would have been a personal judgment against Mann and would have required him to pay the judgment out of his own personal funds and not out of the moneys received from plaintiff.

POINT III.

The only agreement which could be rescinded is the agreement between the syndicate managers and Edenborn for the purchase of his stock in the United States Iron Company.

If there was anything unconscionable in the contract between the syndicate managers and Edenborn for the purchase of Edenborn's stock in the United States Iron Company, or perhaps even if it were a fair contract and no undue advantage taken of the syndicate, and it was not ratified and approved by the other syndicate subscribers, or by the Sheffield Coal & Iron Company, into which their interests were consolidated, that contract could, by appropriate action, have been rescinded. But even in that case that contract could only be rescinded by the parties to it, and upon restoring to Edenborn everything which he parted with, and such other parties, would then be entitled to recover back only what they actually paid to Edenborn. No one member of the syndicate would be entitled even in that case to avail himself of the right to rescind, for that purchase was made on behalf of the syndicate as a whole; and while some members of the syndicate might wish to rescind, the other members might not be entitled to do so,

or might not desire to do so, but might prefer to hold for the syndicate the property so purchased. Rescission could only be effected by a majority of the syndicate subscribers, if the transaction was fair and no undue advantage was taken of the syndicate by Edenborn. (Pollitz *v.* Wabash R. R. Co., 207 N. Y. 113, 127, 128.)

Even if the property was divisible or Edenborn's interests in the property were separable, it would of course not be possible for any one member of the syndicate to rescind *pro tanto,* because it would be impossible for him to restore *pro tanto.* If the syndicate as a whole, or the Sheffield Coal & Iron Company, into which their interests were consolidated, were entitled to rescind it would be impossible for them to do so at the present time because it would be impossible to restore the *status quo.* The only way in which that could be done would be for the new company to convey to Edenborn the *pro rata* share in the property formerly of the United States Iron Company, in proportion to his former interest in that company. If it were practicable for the Sheffield Coal & Iron Company, representing such syndicate subscribers, to make such restoration, all that it would be entitled to recover would be his stock of the Sheffield Coal & Iron Company which was delivered to Edenborn in payment therefor.

The syndicate agreement is one between all the subscribers to the syndicate to do those things which the syndicate agreement provides for doing. In addition to this, it is an agreement between all the subscribers and the managers of the syndicate who have been chosen to act for and on behalf of the entire syndicate, and who have been vested with certain powers and having enjoined on them certain duties under that agreement. We insist

that the attempt made at rescission in this case has not reached, and cannot reach, the only transaction which in our opinion is legally capable of rescission. The syndicate managers to whom is entrusted certain powers and duties, purchased Edenborn's interest in the stock of the United States Iron Company (Fol. 2259), though it is stated in the referee's first finding of fact that Edenborn owned this stock until he transferred it to the Sheffield Coal & Iron Company in December, 1902 (fols. 346, 2160); the syndicate managers also purchased the Mann property (fol. 2274); they also purchased coal property in Virginia and blast furnace property (fols. 302, 304, 351, 2167). After the subscription by plaintiff the name of the United States Iron Company was changed to that of the Sheffield Coal & Iron Company, and the capital stock increased from $1,000,000 to $2,500,000, and plaintiff received the exact amount of his subscription to the syndicate agreement in the stock of the Sheffield Coal & Iron Company at par (fol. 2268). This stock was evidently a part of the 25,000 shares of stock that the syndicate managers directed the Sheffield Coal & Iron Company to distribute among the subscribers to the syndicate agreement in amounts equal to the amount of their respective subscriptions (fol. 2270); the syndicate, acting through its managers, acquired the Edenborn stock in the United States Iron Company. It did not acquire this stock any more nor any less than it acquired the coal property or the blast furnace property. The only transaction which is capable of rescission, if the facts warrant it, is the contract by which Edenborn's individual stock in the United States Iron Company passed to the syndicate or to the Sheffield Coal & Iron Company through the agency of

the syndicate managers. Defendant's subscription to the syndicate agreement was for $500,000. and was subsequently reduced to $475,000. (fol.). At that time he owned 5,365 shares out of the total outstanding capital stock of the United States Iron Company of 9,250 shares, and in part payment of his subscription he transferred the said 5,365 shares of stock in the United States Iron Company to the syndicate at $70 per share (fol. 2259); in other words, it is conceded that the stock of the United States Iron Company was purchased for the sum of $467,000, and Edenborn's interest in said stock was purchased for $375,000 (fol. 2259). The total capitalization of the new company was $2,500,000. The purchase of the stock of the United States Iron Company owned by the Williams estate of 518 shares (fol. 2263), and by Elwood of 2201 shares (fol. 2257) is not condemned because of any trust relationship which they sustained towards the syndicate subscribers. It is not claimed that the purchase of the remainder of the property by the syndicate should be set aside because of anything done by Edenborn. The remainder of the money subscribed, about $2,000,000 went into equipment, blast furnaces, coal lands and other property.

The Court of Appeals said in the case of Hecksher *v.* Edenborn, 203 N. Y. 210, 215, "of the $2,500,000 subscribed, $647,500 in effect was expended for purchasing the entire capital stock of the United States Iron Company at $70 per share".

Edenborn's stock was included in this purchase. Continuing, the Court said:

"The balance of the aggregate subscriptions, with the exception of something over $900,000, which was reserved for future use, was expended

in purchasing other properties. As has already been indicated, respondent purported to pay his subscription of $500,000 to a large extent by turning in his holdings of the capital stock of the Iron Company at $70 per share" (p. 215).

So we have $2,124,450 of the total $2,500,000 of capital stock subscribed concededly going into property under the direction of syndicate managers or their successor, the corporation, about the purchase of which there can be no objection. An action in equity against William Edenborn alone for a rescission of the syndicate agreement could not be successfully maintained and we do not think that an action at law by a subscriber based on a rescission could be successfully maintained against Mr. Edenborn alone. The Court of Appeals further said (page 230):

"The agreement authorizing the purchase and organization of various properties was an entire one. The conclusion has been reached that so far as it authorizes the purchase of or related to defendant's property, it was constructively fraudulent, even though there was no actual fraudulent motive on his part."

To say that the syndicate agreement, when signed by a subscriber, was in any sense fraudulent because it authorized the purchase of Edenborn's property, in our opinion, misconceives or misunderstands the point. It was perfectly legitimate for the syndicate agreement to provide for the purchase of Edenborn's property as heretofore discussed. It was perfectly legitimate for him to procure signers to that agreement. This agreement at no time ever became subject to rescission for fraud. The fact is that the fraud occurred, if at all, not when the syndicate agreement was signed, but when the syndicate pur-

chased Edenborn's stock. It was this additional step that made the transaction constructively fraudulent. Therefore, we cannot assent to the statement in the opinion of the Court of Appeals—that the syndicate agreement was constructively fraudulent. Judge Hiscock further says: "I see no way by which the instrument can be subdivided." See what a far-reaching result this would be: $2,124,450 worth of other property, purchased by the syndicate, to which no objection can be made by any one, is claimed to be affected by Edenborn's act. Yet if this decision is followed, Edenborn is not only compelled to rescind the arrangement by which he and his associates got his property and turned it over to the syndicate, but he is compelled to return to the stockholders $2,124,450.00 worth of stock which had concededly no fraudulent connection with his failure to disclose his interest in the stock of the United States Iron Company. If this is correct, Edenborn is bound to take the stock of every individual in this corporation who comes before the Court and swears that he did not know that Edenborn was the owner of this stock. Plaintiff claims that defendant was his agent and that he could therefore rescind not the transaction by which the agent's property was purchased, but the very transaction in which he was appointed his agent. On the other hand, we assert that he never was the agent of plaintiff, certainly not until after the syndicate contract was made, and that even then the syndicate as a whole was the principal and that the syndicate managers were the agents of the syndicate only and not of each individual subscriber. The Sheffield Coal & Iron Company succeeded to all the rights of the syndicate and it is through that company, if at all, that the purchase of Edenborn's property may be rescinded.

Prior to the transfer of the property to the Sheffield Coal & Iron Company the rescission could have been effected by the syndicate as a whole if the facts justified it. Similar situations have frequently arisen, but usually in cases where a fraudulent profit was made in the transaction, and the books are full of cases where some individual undertook to obtain subscriptions to an agreement to buy property and turn it into a corporation, and where it subsequently developed that such person was interested in the property sold or had obtained some profit out of the transaction which he had failed to disclose. But no case can be found in which, as here, the subscriber has been allowed to rescind his subscription contract by tendering to the agent or promoter stock not received from him, and recover back the amount of the subscription which was not paid to him.

Edenborn does not question the general doctrine that where an agent has bought property for his principal without disclosing his interest in it, the principal may rescind the sale in a proper case. The difficulty with the present case is in confusing the parties to the transaction and the contracts, and misstating the remedy. The plaintiff claims that defendant was his agent and that he could, therefore rescind, not the transaction by which the agent's property was purchased, but the very transaction in which he was appointed an agent. On the other hand, defendant asserts that he never was the plaintiff's agent, certainly not until after the syndicate contract was made, and that even then the syndicate as a whole was the principal, and that the syndicate managers were the agents of the syndicate only and not of each individual subscriber. The Sheffield Coal & Iron Company succeeded to the rights of the syndicate, and it is through that company, if at all, that the pur-

chase of Edenborn's property may be rescinded. Prior to the transfer of the property to the Sheffield Coal & Iron Company a rescission could have been effected by the syndicate as a whole if the facts justified it. Similar situations have frequently arisen (though in all cases, with scarcely an exception, a fraudulent profit was made in the transaction), and the books are full of cases where some individual has undertaken to obtain subscriptions to a plan to purchase property and turn it into a corporation, and where it is subsequently developed that such person was interested in the property sold or had obtained some profit out of the transaction which he had failed to disclose. But no such case can be found in which, as here, a subscriber has been allowed to rescind his subscription contract by tendering to the agent or promoter stock not received from him, and to recover back the amount of his subscription which was not paid to the agent or promoter.

What then are the remedies which a subscriber to the stock of the corporation has under such circumstances?

(a) If the subscriber has been induced by fraud to subscribe, he may have an action in the nature of deceit against the one who has made the false representations.

(b) If the subscription to the stock was induced by a false representation of the agent of the corporation, he may bring an action against the corporation for the purpose of rescinding the subscription, or could, perhaps, surrender his stock to the corporation and demand back the money paid for it.

(*c*) If the agent has merely failed to disclose his interest in property sold to the syndicate or cor-

poration, or a secret profit made in connection with such sale, the action belongs to the corporation, which, under proper circumstances, may either rescind the sale, returning the property purchased and receiving back the money or stock paid therefor, or it may compel him to account for the profits obtained by such sale. In case the corporation does not undertake to sue for its own motion, a stockholder may bring suit, joining the corporation as a party defendant.

The cases on this point are numerous and embrace many English decisions of great importance.

New Sombrero Phosphate Co. *v.* Erlanger, L. R., 5 Ch. Div., 73.
Bagnall *v.* Carlton, L. R., 6 Ch. Div., 371.
Twycross *v.* Grant, 2 Com. Pleas Div., 503.
Whaley Bridge Calico Printing Co. *v.* Green and Smith, L. R., 5 Q. B. Div., 109.
Emma Silver Mining Co. *v.* Grant, 11 Ch. Div., 918.
Lydney *v.* Wigpool Iron Co. *v.* Bird, L. R., 33 Ch. Div., 85.

In this country there are also many cases:

Joplin Land Co. *v.* Case, 104 Mo., 572.
Cortes Co. *v.* Thannhauser, 45 Fed. 730.
Simons *v.* Vulcan Oil, &c., Co., 61 Pa. St., 202.
Pittsburg Mining Co. *v.* Spooner, 42 N. Y., 259 (Wis.).
Parker *v.* Michigan, 112 Mass., 195.
Yale Gas Stove Co. *v.* Wilcox, 64 Conn., 101.
Chandler *v.* Bacon, 30 Fed., 538.
Ex-Mission Land Co. *v.* Flash, 32 Pac., 600 (Cal.).
Burbank *v.* Dennis, 35 Pac., 444 (Cal.).
Colton Improvement Co. *v.* Richter, 26 Misc., 26.
Insurance Press *v.* Montauk Fire Co., 103 A. D., 472.
Brewster *v.* Hatch, 122 N. Y., 349.

In each of these cases the amount of damage is restricted carefully to the profits made by the promoter; or, if a rescission is permitted, only the sale of such property as has been actually transferred by the promoter to the corporation is abrogated and the amount paid for such property returned to the corporation There is never any attempt to mulct the promoter beyond what he actually received.

In several cases this is particularly apparent, such as Bagnall *v.* Carlton and Emma Silver Mining Co. *v.* Grant, *supra,* where the promoter's expenses in connection with the sale were allowed.

In these cases it is also clear that the corporation is the proper party plaintiff and that the shareholders' only right is through the corporation.

Morawetz on Corporations, Section 292, in commenting on the New Sombrero Phosphate Co. case, says:

> "The fraud really consisted in inducing the shareholders to enter into this contract in their collective capacity, and in using the funds belonging to the shareholders collectively in paying the purchase price. It is evident, therefore, that the injury to the shareholders was an injury to their collective or corporate interests, and that the company was the proper complainant."

In none of these cases is there any attempt made to, nor is there any authority to be found anywhere, for the contention that a shareholder could compel the promoter to take his stock off his hands, thus making the promoter the purchaser of practically all the outstanding stock of the corporation. We have already shown that such would be the result in this case if the present judgment were allowed to stand. If the plaintiff desires that the

sale of Edenborn's property to the syndicate should be rescinded he should have brought his action, joining the corporation as defendant in case the company refused to take such action itself. It may be that he was unwilling to pursue that course because of the fact that the property sold by Edenborn was of such value as to make it unwise to return it to him. If it were true that Edenborn had made any profit out of the transaction that could be recovered in the same manner. If Edenborn had induced the plaintiff to subscribe to the syndicate agreement by fraudulent representation, the plaintiff could recover his damages in an action for deceit.

Although, in view of the fact that by the syndicate agreement the subscribers expressly authorized the purchase of this specific property, it is doubtful if they would be entitled to recover in any form of action unless they could show actual fraud or secret profits obtained by the defendant.

Hutchinson *v.* Simpson, 92 App. Div., 398.
Blum *v.* Whitney, 185 N. Y., 240.

POINT IV.

Plaintiff and his assignors did not offer to and did not place defendant in statu quo.

The referee found the existence of a syndicate agreement (fol. 347); that the consolidation proposed in said agreement was carried out (fols. 351, 2160); that the subscriptions of the plaintiff and his assignors were paid to and received by all of the syndicate managers as such (fols. 2166, 2167); that the plaintiff and his assignors elected to rescind, notified the syndicate managers, and offered to restore and return the stock

which each had received and demanded the return of their money (fol. 352); that defendant's failure to disclose his ownership of the stock of the United States Iron Company operated in law as a fraud on plaintiff and his assignors (fol. 355); and that plaintiff was entitled to recover the sums paid him, with interest (fol. 356). The defendant excepted to these findings. (See exception No. 6, fol. 2312; exception No. 8, fol. 2313; exception No. 10, fol. 2314; and assigned error on this action of the court, fols. 2480, 2483, and 2485).

In the case of Grymes *v.* Sanders, 93 U. S. 55, the United States Supreme Court said:

> "A court of equity is always reluctant to "rescind unless the parties can be placed *in* "*statu quo*. If this cannot be done it will give "such relief only where the clear and strong- "est equity imperatively demands it."

The general doctrine of rescission has been clearly stated by the Court of Appeals in the case of Cobb *vs.* Hatfield, 46 N. Y. 537, where Judge Allen said:

> "The law not only requires a disaffirmance "of the contract at the earliest practical "moment after discovery of the cheat but a "return of all that has been received under "it and the restoration of the other party to "the condition in which he stood before the "contract was made."

In the case of Francis *vs.* N. Y. & B. L. R. R. Co., 108 N. Y., 97, Judge Finch said:

> "The theory of rescission is that the party "proceeded against shall be restored to his "original position."

And he further held under the facts of that case that the alleged rescission was ineffective because it was "very far from restoring the company to its original position."

In the case of Curtis *vs.* Howell, 39 N. Y. 215, the Court of Appeals said:

> "When the power to restore ceases, the "right to rescind ceases."

The case of Getty *vs.* Devlin, 54 N. Y., 403, is directly in point, although that was a case of gross actual fraud and was a suit in equity. In that case four persons, owning certain oil land which had cost them about $30,000, agreed to combine their interests, to organize a company and transfer their interests to the company at a large price above the cost and to divide the profits. To carry out this purpose they procured a subscription paper to be drawn up, by which the subscribers agreed to pay the sums subscribed for the purchase of property, specifying therein the lands above mentioned, at the sum of $125,000. Each of the four persons interested in the property subscribed $5,000 and caused certain others to sign as decoy subscribers for about half the amount subscribed. These subscriptions were not in fact paid, although so marked, and it was never intended that they should be paid. The plaintiffs, induced by the fraudulent assurances of one of the originators of the scheme that the land originally cost $125,000, and upon the belief that they became subscribers on a footing of equality with the others, subscribed and paid in their subscriptions. The moneys so paid were received and divided by the four associates. The company was thereupon organized, the property transferred to it, and stock taken in payment and divided *pro rata* among the subscribers, as well those who had not as those who had paid.

The court expressly held that the plaintiffs could not, on account of the fraud, recover back money paid by them, because they could not re-

store the four defendants to the position they were in before the transfer of the real estate, and that by returning the shares of stock which they held in the company which had taken title to the real estate, they did not put the four defendants in the position which they originally occupied, because what the defendants parted with was the real estate, and that had passed beyond their control. But, this being an action in equity, the court held that the defendants might be compelled to account for the profits they had made upon the real estate and which they had fraudulently appropriated to the exclusion of their associates. The court, after considering the gross fraud of the defendants and stating that the plaintiffs were entitled to relief in some form said, with peculiar pertinence to this case:

> "They could not, on account of the fraud, recover back all the money paid by them, because they could not restore the four defendants to the position they were in before the transfer of the real estate to the company. The real consideration for the money subscribed and paid was the real estate which was conveyed to the company at the request of the subscribers. The company took the title to the real estate, and then their interest in the company and through it in the real estate was represented by shares of stock. The plaintiffs did not place the four defendants in the position they were before the real estate was conveyed, by returning their stock, because what the defendants parted with was the real estate, and that had passed beyond their control. The plaintiffs caused it to be seized and sold for their debts against the company, after the discovery by them of the fraud of which they complain. It is a rule, quite uniform, that a party who seeks to recover back money which he had been induced to pay for property by fraud, must restore

the property before he can rescind the contract of purchase and recover the money paid. And he must act promptly upon the discovery of the fraud (Cobb *v.* Hatfield, 46 N. Y. 533; Masson *v.* Bovet, 1 Denio, 69; Moyer *v.* Shoemaker, 5 Barb., 319). It matters not, so far as I can discern, that it is difficult or even impossible for him to do so, so long as he is not prevented by the act of the wrongdoer. Before he can adopt this form of remedy he must do it, and the action in such case may be at law. All the defrauded buyer has to do is to tender back what he has received, and then he can commence his action at law to recover the money paid. In this case, if the tender of the release of the stock was sufficient, no resort to equity was necessary or proper, as each one of the plaintiffs could at once, after the tender, have sued in an action at law to recover the amount of money paid by him. A joint action by all the plaintiffs would not have been proper. Hence, this action cannot be maintained for the recovery of the entire amounts paid by the plaintiffs, upon the theory that they have restored to the four defendants all that they parted with for plaintiff's money."

Vail *vs.* Reynolds, 118 N. Y. 297.
Hammond *vs.* Pennock, 61 N. Y., 145.
Pullman *vs.* Alley, 53 N. Y., 637.
Gould *vs.* Cayuga Nat. Bk., 86 N. Y., 75.
Hogan *vs.* Weyer, 5 Hill, 389.
Bedell *vs.* Bedell, 3 Hun, 580.

The English cases on the question of rescission are uniform and in accord with the authorities cited in the United States.

In Re Cape Breton Co., 19 Ch. D., 77, the court held:

"In 1871 certain coal areas were purchased for £5,500 by six persons, of whom F. was

one, and were vested in G. as a trustee for them without disclosing the trust. In 1873 a company was formed for the purpose of purchasing these areas and other property. F. was one of the directors, and as such he concurred in effecting a purchase by the company from G. for £12,000 cash and £30,000 in fully paid-up shares, without disclosing the fact that F. was a part owner. In 1875 the company was ordered wound up. In 1878 a meeting of the contributories was called, at which two rival schemes were brought forward, one for repudiating the purchase of the coal areas, the other for adopting the purchase and selling the property. The latter scheme was adopted and was confirmed by the court. The liquidator accordingly sold the property, but at a heavy loss. A contributory then took out a summons under sect. 165 of the Companies Act, of 1862, to make F. liable for misfeasance as a director in allowing the company's seal to be affixed to the agreement for purchase by the company. Mr. Justice Pearsons dismissed the summons, holding that though the company would have been entitled to rescind the contract, yet as rescission had become impossible, no relief could be given against F.

Held, by Cotton and Fry, L. JJ., *dissentiente*, Bowen, L. J., that this decision was right.

* * * * * * * *

Cotton, L. J. "* * * It is material on that part of the case to consider what I have already mentioned—that the company was expressly formed for the purpose (among other things) of acquiring this particular property. The directors therefore were not acting under a general authority to buy property. If they had been, it might be said that when an agent does not buy, but hands over to his principal property of his own, he has not performed the commission entrusted to him. No authority has been quoted to show

that even in that case a director would be liable to an action by any shareholder for not having performed the duty which was entrusted to him by the company, and in my opinion such an action could not be maintained. There could be no action at law, and it cannot be considered that a contributory can acquire a right to bring in substance such an action by taking out a summons under sect. 165. Subject to what we might hear in arguments, for we have not heard the respondents on this point, and assuming that the whole circumstances were not in fact known to the board and to the company at the time of the purchase, the company, if so minded, might have set aside this purchase altogether. Where a trustee purchasing on behalf of his *cestui que trust,* purchases his own estate without disclosing his own interest in it, the *cestui que trust* when he discovers the fact, may, if he pleases, set aside the contract altogether, but then he must return that which has been purchased. The same rule applies in the case of a purchase by a director on behalf of a company, of property in which he has any interest; if the company repudiates the contract, the property must be returned. In this case a return of the property is impossible after what was done in 1878."

Bentinck vs. Fern, 12 App. Cas., 658:

Lord Herschell,

"Now there can be no doubt that inasmuch as Mr. Fenn was interested with his partner Mr. Crosthwaite to the extent of three-tenths of the value of these three coal areas, holding three-tenths of the shares in the Coal Area Association Limited, he was bound to disclose that interest to the other directors of the new company who were entering into a contract for the purchase of them, and his failure to make that disclosure would entitle the company, upon discovering his interest, to rescind the sale. I think about that there can

be no manner of doubt, but at the present time rescission has become impossible. * * *

"Again, there probably is little doubt that if an agent of a company is employed by that company to make a purchase for them in the market of goods of any description, and if instead of making that purchase in the market at the market price he sells to his company goods of the required description which he happens to own, at a price in excess of the market price, he can be made to pay to the company that excess, so as to leave their purchase, as it ought to have been, at the market price according to the obligations which he is under to them. But in the present case the purchase that was made was a purchase of specific property, it was that specific property alone which the agent, the director, was authorized to purchase; it was not left to him to purchase, at the best price at which they could be obtained, goods or land of a particular description, but his agency, so far as it existed at all, was an agency to purchase this specific property in which it is proved he had an interest.

"Now, I am by no means prepared to say that the argument of the appellant is well founded that such a case as this is a parallel case to the class of cases to which I have alluded, where an agent employed to go into the market and buy at the market price sells his own goods to the company at something above the market price. But I do not think it necessary to come to any absolute determination upon that point, because it is of the very essence of such a case as this to show that the price at which the property was sold to the company was in excess of what has been called the real price or the true value. Now what evidence is there here, upon which your Lordships would be entitled to act, that the property in question when purchased by the company was sold to them at a price in excess of the real value, or the market value

or the true value in which ever way you put it? I admit that there may be considerable ground for suspicion that the price was in excess of it. But obviously for such a case as the appellant seeks to make out here much more than that is necessary. It is of the very essence of the case, which rests upon his proving what he claims, namely, a secret profit improperly made, that he should prove that there has been that excess which he alleges. * * *"

Ladywell Min. Co. *vs.* Brookes, 35 Ch. D. 400:

"On the first of February, 1873, five persons (one of whom was a solicitor and conducted the negotiations) purchased a leasehold mine for £5,000 with a view of reselling it to a company to be formed; but they had at that time taken no steps to form any company. They completed their purchase on the 17th of March, 1873, the purchase money being paid out of their own moneys, and on the 4th of April they entered into a provisional contract with a trustee for an intended company for the sale of the mine to the company for £18,000. On the 8th of April, the company was registered under the Companies Act, its principal object being, as stated in the memorandum of association, the purchase of the mine, and in its articles the contract of the 4th of April, 1873, was adopted and confirmed, and four of the vendors were named as directors; but the contract of the first of February, 1873, was not disclosed to the company. The whole of the shares were placed by the vendors, and the share capital (£30,000) paid by them. At the same time they received £18,000 from the company as the purchase-money for the mine. In 1882 the company was wound up voluntarily, and in the course of the winding-up the facts relating to the purchase of the mine by the vendors became known to the company. In 1883 the company allowed judgment by default to

go against them in an action by the lessor to recover possession of the mine. In 1884 the company commenced two actions against the executors of three deceased vendors and the two surviving vendors to recover the secret profits made by the vendors on their sale to the company, on the ground that they stood in a fiduciary position to the company:

Held (affirming the decision of Stirling, J.), first, that the evidence did not prove that the vendors when they purchased the mines were promotors of, or in a fiduciary position towards the company which was ultimately formed; secondly, that assuming that the vendors committed a breach of duty in not informing the company after it was formed that the mine was their own property, and consequently that the company might have rescinded the contract, yet as rescission was now impossible, the company could not recover from them the profits which they had made. The action was accordingly dismissed."

In Re Lady Forest Gold Mine (1901), 1 Ch. 582:

"A syndicate, of which S. was a director and member, was formed in February, 1895, to acquire and work a mine, and in the same month issued a prospectus showing that the directors were aware that similar properties were often resold 'to the public' at a profit, and were 'not unmindful of the benefit that' might 'arise by converting the syndicate into a very much larger company within a short period.'

In October, 1895, the directors promoted and brought out a company, with a larger share capital than that of the syndicate, to purchase the mine on the terms of an agreement, already entered into in the same month with a trustee for the company, which provided for the payment of a purchase money much larger than what had been paid for and expended upon the mine by the syndicate.

The same persons were the directors of both the syndicate and the company. In the same month the company issued a prospectus offering some of its shares for public subscription and stating the names of its directors that they were directors of the syndicate selling to the company, and the date of, parties to, and consideration for the sale to the company. Inspection of the contract was also offered. The amount of profit on the resale to the company was not stated, and subject as aforesaid, there was nothing in the prospectus to show that the sale was at a profit.

The court found as a fact that when the syndicate acquired the mine it had no present intention of reselling to or forming another company, but contemplated working it in the first instance.

In the winding-up of the company it was sought to make S. liable on a misfeasance summons for the secret profit received by him as a promoter of the company.

Held, (1) that the syndicate and its directors were not promoters of the company when the syndicate acquired the property.

(2) That the disclosure in the prospectus of the company of the fact that the directors of the syndicate were directors of the company was a disclosure that some profit was being made.

(3) That S. and the other directors were guilty of a breach of duty in not disclosing what profit had been made on the resale to the company.

(4) That although the company might have had a right to rescind the contract S. could not be ordered to repay the profit which he had derived from the resale to the company.

Gluckstein *v.* Barnes, (1900) A. C. 240, distinguished.

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"There is the decision of the other two members of the Court of Appeals in Re Cape Breton Co., (1) which has been sometimes ex-

plained as proceeding upon peculiar facts; there is the case of Ladywell Mining Co. *vs.* Brookes (2) which has not been so explained; and there is the statement of Lord Cairns in Erlanger *vs.* New Sombrero Phosphate Co.—(3) all of which appear to me to go to this result: that although there is a breach of duty in such a case sufficient to entitle the vendee company to rescind or repudiate the contract if matters have not been too much altered in the meantime, nevertheless there is sufficient ground for requiring a person in the position of Mr. Simpson to repay the profit or the benefit that he has received out of the sale. It is quite true, I think, that the cases on which so much reliance has been placed on Mr. Simpson's behalf have been to some extent doubted, perhaps even questioned, in later cases, and certainly some of them have been cited and discussed and have not been been cited and disucssed and have not been expressly dissented from, still less overruled, in any case to which I have been referred."

The stock which the plaintiff and his assignors offered to deliver to the defendant never was the property of the defendant and he never had any interest of any kind therein. The defendant Edenborn never owned plaintiff's subscription to the syndicate agreement, yet plaintiff and his assignors have obtained a judgment which in effect compels Edenborn to purchase or take off plaintiff's hands the shares of stock which they purchased in the Sheffield Coal & Iron Company. Whatever the plaintiff and his assignors may do in this case may be done by all the subscribers to the syndicate agreement who can show that they did not know of Edenborn's interest in the stock of the United States Iron Company at the time they subscribed. If this judgment can be sustained then Edenborn can be

compelled to accept and pay for the stock of all the other subscribers amounting to two million dollars. He can be made to accept the ownership of stock for which he never contracted and which he never at any time owned and in which he never at any time had any interest. Before the syndicate agreement he owned 5,365 shares of the stock of the United States Iron Company which was turned in to the Sheffield Coal & Iron Company for $375,550. After a rescission by all the subscribers, in the event they should decide to rescind, as has been done by plaintiff below in this case, Edenborn would own all of the stock of the Sheffield Coal & Iron Company. This same result would be reached although his interest in the United States Iron Company amounted to only one thousand dollars; that is if his interest in the stock of the United States Iron Company had amounted to only $1,000.00 the other subscribers could under the rule of law announced in the Hecksher case compel the defendant to take over their subscriptions amounting to $2,449,000. The parties could not be placed *in statu quo* by rescinding the subscription contract between defendant and plaintiff because it is now converted into shares of the Sheffield Coal & Iron Company and that company is the only party liable in an action for rescission, if one can now be sustained.

When the subject matter of a contract has been so dealt with that the court cannot place the parties in their original state there can be no rescission but the parties must be left to an action for damages.

Furness *v.* Grove, 12 How. 51.
Murray *v.* Watson, 8 Cow. 238.
Curtis *v.* Howell, 39 N. Y. 211.
Padden *v.* Taylor, 44 N. Y. 371.

The court instead of restoring to defendant Edenborn the $375,550 worth of property which he put into the enterprise, and, as the law requires, putting him *in statu quo*, would compel defendant Edenborn to enter into a new contract by which he is to become the subscriber to two million dollars of stock, in addition to the $375,550 worth of property which he put into the enterprise and the additional stock for which he paid in cash. Instead of putting him *in statu quo*, the court would in this manner make him the sole owner, with one or two exceptions, of all the stock of the Sheffield Coal & Iron Company, and this notwithstanding the fact that all of the property which was purchased by the syndicate outside of the stock of Edenborn in the United States Iron Company was property in which Edenborn had no interest whatever.

The remedy of rescission is an equitable remedy resorted to for the purpose of doing equity, and not for the purpose of perpetrating a wrong and hardship. The referee has found that the syndicate agreement was entered into in good faith on the part of defendant, (fol. 2154); that no statements were made by defendant with the intent to deceive, defraud or mislead plaintiff or his assignors (fols. 2158, 2172, 2179, 2184, 2188, 2193); that the defendant did not intentionally conceal his interest in the United States Iron Company from the plaintiff and his assignors (fols. 2163, 2164).

We submit that it was Edenborn's duty as well as that of the syndicate managers who represented plaintiff and his assignors to carry out the syndicate agreement. It was entered into in good faith by Edenborn, without any intent to conceal his interest in the stock of the United States Iron Company; it is evident from the findings that

Edenborn believed that plaintiff and his assignors knew all about his interest in the United States Iron Company; the provisions of the agreement were carried out in good faith by Edenborn and every member of the syndicate at a time when the agreement was in full force and effect. It is submitted that plaintiff's attempted rescission cannot operate so as to invalidate, as between plaintiff and defendant, what was done under that agreement. The plaintiff was represented by the other syndicate managers, who had no interest in the United States Iron Company and who could control the action of the syndicate with respect to the propriety of the purchase of Edenborn's stock.

We contend that the rule announced by the Court of Appeals that defendant cannot set up the syndicate agreement to justify acts done under it and to prevent a rescission after plaintiff has taken advantage of the right to rescind, is manifestly erroneous under the facts in this case. This might be the proper rule in some cases but should not apply to a case where there was no attempt to deceive or conceal; where the fraud, if any, resulted only by operation of law. We think rescission cannot be accomplished here because defendant cannot be placed *in statu quo,* because it would be inequitable to place a heavy punishment on him where he acted in perfect good faith, as appears from the findings of the referee in this case.

The findings of fact under the rules of law hereinbefore announced show that petitioner is not entitled to judgment because they show that respondent under the peculiar circumstances of this case, cannot be placed *in statu quo.*

POINT V.

The court erred in not sustaining the demurrer to the complaint.

Defendant demurred to the complaint on the following grounds, among others: (1) that it did not state facts sufficient to constitute a cause of action; (2) that there is a defect of parties defendant because of the omission of August Mann and J. C. Walker, the other two syndicate managers; (3) that there is a defect of parties defendant because of the omission of the Sheffield Coal & Iron Company (fol. 169). The demurrer was overruled (fol. 177) and interlocutory judgment to that effect entered (fol. 180). The defendant assigned error to the action of the court in overruling the demurrer (fols. 2360, 2361, 2362, 2363).

We think this demurrer should have been sustained for the reasons which have been fully presented in the preceding points of this brief and which we shall not here repeat.

If the propositions of law heretofore laid down are correct, the complaint was demurrable because there was a defect of parties in that Walker and Mann, the other syndicate managers, were not made parties thereto and because the Sheffield Coal & Iron Company was not made a party thereto. The complaint was also demurrable because it failed to show that the agreement was capable of rescission; it failed to state that petitioner had in fact offered to place respondent *in statu quo;* and it failed to show that respondent could be placed *in statu quo.*

POINT VI.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

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